UMBC SECURITIES SDN BHD

v.

TAN CHEE AAN

HIGH COURT MALAYA, KUALA LUMPUR
KANG HWEE GEE J
[CIVIL SUIT NO: D5-22-435-1994]
22 NOVEMBER 2000

SECURITIES: *Shares - Whether shares sold on the instruction of defendant - Force-selling - Whether force-sell of shares after eighth day of transaction illegal and unenforceable in law - Securities Industry Act 1983, s. 9 - Whether parties may modify rules for mutual benefit - Conduct of defendant - Whether attracts doctrine of estoppel in plaintiff's favour*

CONTRACT: *Agreement - Terms - Whether plaintiff may rely on terms - Whether sale was conducted bona fide in parties' best interests*

The plaintiff is claiming against the defendant for payment due on contra loss of shares bought on the instruction of the defendant, which had to be forced-sold as a result of the defendant's failure to pay for them by the seventh day following the day of transaction.

Both parties agreed that only two issues remained unresolved, *ie*: i) sales of certain shares by the plaintiff which the defendant alleged were carried out without his instruction; ii) that the defendant disputed legality of the sale of certain shares by the plaintiff which were forced-sold after the eighth day of transaction (referred to as "T + 8" in this industry). The defendant argued that the sale had contravened the Kuala Lumpur Stock Exchange ("KLSE") trading regulation pertaining to force-selling and had rendered the force-sell transaction invalid. Subsequently, the defendant contended the plaintiff would not be able to recover the contra loss in respect of these lots of shares.

Held:

[1] At the trial, only the plaintiff's witness, a dealer representative on behalf of the plaintiff's company gave evidence. The defendant did not call any witness to substantiate his defence. It followed that the plaintiff's evidence must be accepted that the shares were indeed sold on the instruction of the defendant. The cross examination of the witness failed to elucidate from him that the defendant did not instruct him to sell.

[2] In order for the defendant to succeed on the ground as contended in the second issue, the force-sale of shares after the T + 8 period will have to come within that category of performance which is prohibited by statute, *ie*, the Securities Industry Act 1983 ("the Act"), so as to render it (the sale of the shares after the T + 8 period) illegal and unenforceable in law.

[2b] A perusal of the s. 9 of the Act reveals that it enumerates the duties of the stock exchange and ensures that its members comply with the exchange's rules. The section injuncts upon to ensure that due compliance of its directives is on the KLSE as a body corporate and not its component members such as the plaintiff. As such, it can be certain that the selling of shares on dates later than the T + 8 period had not contravened the Act or any other law.

[3] Even though both parties carry an obligation to abide by the rules and regulations of KLSE and the Act, this does not mean that the parties were not free by consensus to modify the requirements of the rules for their mutual benefit such as to postpone sales to a date when the shares would fetch a higher price.

[4] On the evidence, the shares were sold after the T + 8 period only because the defendant had requested for time to pay for them. This may show that the parties had varied the force-sale regulation to the extent that it would be legitimate for the shares to be sold at a date later than after the eight day.

[4b] Even if the evidence is discounted, the conduct of the defendant attracts the doctrine of estoppel on account of the fact that he had not raised any objection whatsoever over the sale of shares by the plaintiff when it was expected to do so, if he had not agreed to the sales and in the process influenced the plaintiff to believe that the sale was perfectly regular.

[5] The plaintiff was permitted to rely on cl. (f) in the "Account Application for individual" form which outlined the terms and conditions agreed to between both parties. The form authorised the plaintiff to deal with the shares "in any manner you deemed fit" *ie*, to sell the shares at the appropriate time they deemed fit. Provided the sale was conducted *bona fide* to recover the loss that the plaintiff may have to incur by the failure of the defendant to pay for them, the sale could not be impeached.

[Plaintiff's claim allowed; Defendant's counter claim dismissed with costs.]

Case(s) referred to:
Berry v. Berry [1929] KB 316 ***(refd)***
OSK & Partners Sdn v. Tengku Noone Aziz & Anor [1983] 1 MLJ 179 ***(refd)***
Paul Murugesu Ponnusamy (as representative of Nalamah Sangapillay (deceased)) v. Cheok Toh Gong & Ors [1996] 2 CLJ 397 ***(refd)***
RHB-Cathay Securities Pte Ltd v. Ibrahim Khan and Other Actions [1999] 3 SLR 464 ***(refd)***
Teh Poh Wah v. Seremban Securities Sdn Bhd [1996] 4 CLJ 16 ***(refd)***
Theresa Chong v. Kin Khoon & Co [1976] 2 MLJ 253 ***(refd)***
YK Fung Securities Sdn Bhd v. James Capel (Far East) Ltd [1997] 4 CLJ 300 ***(refd)***

Legislation referred to:
Securities Industry Act 1983, ss. 9(8), 84

Other source(s) referred to:
Chitty on Contracts, 1999, vol 1, pp 17-147

For the plaintiff - Pathmanathan; M/s Skrine
For the defendant - SK Lam; M/s Manjit Sachdev, Mohammad Radzi & Partners

Reported by Raja Vishnu Sivarajah

JUDGMENT

Kang Hwee Gee J:

The plaintiff's claim against defendant in this suit is for the payment of the sum of RM823,079.10 due on contra loss of shares bought on the instruction of the defendant which had to be forced-sold when the defendant failed to pay for them by the 7th day following the day of transaction.

The Issues

By the grace of both counsel, much time had been saved in the conduct of this trial. They had sat in conference on a professional basis to identify the issues that ought to go for trial before the court, the findings of which would determine whether the plaintiff would succeed in its claim. In doing so they had in turn spared me the tedious task of having to surf the contents of the pleadings in order to mark out the issues.

At the commencement of proceedings they informed me that only two issues had remained unresolved.

The first relates to the sales of certain shares by the plaintiff which the defendant alleged were carried out without his instruction. These had been set out in a table in an agreed bundle of documents which the parties had labouriously prepared and marked as ABD4, pp. 1 to 6.

The second relates to the legality of the sale of certain shares which were initially purchased on the instruction of the defendant but which had to be forced-sold by the plaintiff when the defendant failed to pay for them by the 7th day after the day of transaction (referred to in the industry as T + 7). These were also set out neatly in the table ABD4, pp. 7 to 16.

They agreed that the plaintiff would be entitled to enter judgment in full only if these two issues were resolved in its favour.

The Conduct Of The Trial - Witness For The Plaintiff

At the trial only one witness, a Mr. Leow Yuen Fong gave evidence. He was the plaintiff's dealer's representative who dealt directly with the defendant in all the sales and purchase of shares undertaken by the plaintiff on behalf of the defendant.

Referring to the sales of the shares referred to in the table ABD4 pp. 1 to 6, Mr. Leow confirmed that the sales were initiated and transacted on the orders of the defendant before the time for payment was up, that is to say, within the seven days following the day of transaction (T + 7) under the KLSE trading rules prevailing at the time.

With respect to the shares listed in ABD4 pp. 7 to 16, Mr Leow confirmed that these were forced-sold by the plaintiff after the defendant failed to pay for them within seven days following the day of transaction (1 + 7) under the same rules, to which I shall revert to later.

He testified that under the rule the plaintiff would be at liberty to sell them on the 8th day (T + 8). But not all the shares listed in the table pp. 7 to 16 were sold immediately on T + 8. This was because the defendant had requested for extension of time to pay for them, on account of the possibility that they may be sold later at a higher price to minimise his loss. They were sold off not later than a month from the day of transaction. Mr. Leow however, maintained that the plaintiff was under no compulsion then to sell the shares on T + 8, as the KLSE did allow its members the leeway to sell them at any time thereafter. He said it was only sometime in April 1994 did the KLSE made it mandatory to sell them on T + 8.

The defendant did not call any witness to give evidence. He was contented to rely only on the submission of his counsel on the legality of the force-sales of the shares which were effected after the T + 8 period, an issue which I shall revert to shortly.

Having failed to call any evidence to substantiate his defence, it follows that Mr. Leow's evidence must be accepted as evidence that the shares set out in the table ABD4 pp. 1 to 6 were indeed sold on the instruction of the defendant.

The cross examination of counsel for the defendant failed to elucidate from him that the defendant did not instruct him to sell. That essentially disposes of the first issue.

The Second Issue - A Question Of Law

That the lots of shares as set out in the table ABD4 pp. 7 to 16 had to be sold on account of the failure of the defendant to pay for them was not in dispute. What was being disputed by the defendant was the legality of the sales of the shares by the plaintiff not on the 8th day, that is to say on the day immediately after T + 7, but after the 8th day.

The sales it was contended, had contravened the KLSE trading regulation pertaining to force-selling, and as such would be enforceable. The plaintiff, it was argued, would therefore not be able to recover the contra loss in respect of these lots of shares from the defendant.

The trading regulation in question was the prescribed regulations for selling-out made pursuant to r. 8 of the Rules For Trading By Member Companies as it subsisted then, read as follows:

Selling Out In Relation to the FDSS (From sub-Regulation 3 of FDSS of Members' Circular No. 713/1990)

> Member companies shall close-off purchase positions of clients who fail to pay for their purchases by 12:30 p.m. on the seventh (7th) market day following the date of contract and shall on immediate delivery basis institute a selling-out by the eighth (8th) day the securities or any of the securities for which the client have not made full payment by the said due date. The Member companies may at any time thereafter sue such clients for the difference and all losses and expenses consequent upon such selling-out. It shall not be necessary for Member companies to give notice of all such selling-out and all damages which the Member companies may sustain shall be recoverable from the clients as liquidated damages.

There could be no doubt that the parties had entered into a perfectly valid brokerage agreement. Its formation was not against public policy. Neither had it offended any law. What is in issue is whether the performance by the plaintiff in not complying with the rule imposed upon it by the KLSE to force-sell the shares on the eighth day of transaction had rendered it invalid. To succeed on this ground, the force-sale of the shares after the 8th day will have to come within that category of performance which is prohibited by statute (that is to say the Securities Industry Act 1983), so as to render it illegal and unenforceable in law.

To settle this issue, reference may be made first to *Chitty on Contracts*, vol 1, 1999 edn, at 17-147 (footnotes excluded) for the principle that it expounded which I accept as correctly stating the law. It will then be necessary to examine the offending rule or regulation of the KLSE to see if the non-compliance of it by the plaintiff was against public policy - or in the extreme whether it offends against statute, in this case the Securities Industry Act 1983.

Chitty at 17-147 - Illegality through the manner of performance.

> The question of statutory illegality in a contract generally arises in connection with its formation, but it may also arise in connection with its performance, since the effect of the statute may be to deprive one or both parties of their rights unless the contract is performed in a particular manner, or, to put the matter another way, the manner in which a contract is performed may turn it into the sort of contract that may be prohibited by statute. Thus, the seller of agricultural fertiliser which omitted to give the purchaser an invoice showing the composition of the fertiliser, was held unable to recover its price since the seller had not performed the contract in the only way in which the statute allowed it to be performed. In another case statutory regulations required that the seller of utility goods should furnish to the buyer an invoice containing certain particulars. The plaintiff made a contract of sale for non-utility goods, to which the regulations did not apply; but he purported to perform it by delivering it to the buyer, without objection, utility garments to which the regulations did apply; and he did not furnish the invoice. The Court of Appeal held that this contract was no less unenforceable than would have been a contract the initial terms of which provided for the sale of utility garments, and which could only have been lawfully performed by the delivery of the requisite invoice.

Rules And Regulations Of The KLSE

Despite the impressive name that it carries and the seemingly officious nature of its rules and regulations, the Kuala Lumpur Stock Exchange (the KLSE) is basically a company incorporated under the Companies Act 1965, much in common with the thousands of others registered with the Registrar of Companies. But unlike them it is a company approved under the Securities Industry Act 1983 to operate "a stock exchange" and its memorandum and articles of association and the rules and regulations made thereunder are regulated under the same Act.

Being a limited company, the exchange is managed by a committee under its articles of association whose power includes the making of rules and regulation of the KLSE.

Abdoolkader J (as he then was) in the Federal Court case of *OSK & Partners Sdn v. Tengku Noone Aziz & Anor* [1983] 1 MLJ 179 at 184, described at 186 the status of the KLSE with respect to the previous Security Industry Act 1973, thus:

> In the light of the provisions of the Act and the constating and governing instruments we have referred to and on an application of the principles of law we have adumbrated, it would appear that the exchange is a hybrid corporation - a company incorporated under the Companies Act but recognised and regulated by the Act and subject to its governance and authority with therefore an element of public flavour superimposed on the contractual elements in relation to its members. It is a statutorily regulated entity under the overall direction and control of the Minister in fundamental respects, thus manifesting a distinctive public element which is reflected particularly in the requirements of the provisions of section 6(2)(b)(vi) and (c) which prescribe the public interest as the prime consideration.

Section 9 of the current Securities Industry Act 1983 enumerates the duties of a stock exchange (such as the KLSE) placing on it the obligation to ensure that the exchange's rules are complied with by its members. Under the same section, amendments to the rules of an exchange, (including the rule requiring its members to force-sell referred to earlier) have to be approved by the Securities Commission. In order that the extent of control which the Commission wielded over the power of the committee of the KLSE to make rules and regulation may be properly appreciated, it is necessary to set out s. 9 in full as follows:

> 9. Commission to approve amendment to rules of stock exchange
>
> (1) No amendment to the rules of a stock exchange shall have effect unless it has been approved by the Commission under subsection (3).
>
> (2) Where a stock exchange proposes to make any amendment to its rules, the stock exchange shall submit to the Commission -
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> (a) the text of the proposed amendment; and
>
> (b) an explanation of the purpose of the proposed amendment.
>
> (3) The Commission shall, within six weeks after the receipt of any proposed amendment under subsection (2), give notice in writing to the stock exchange that it approves or disapproves of the proposed amendment or any part of the proposed amendment, as the case may be.
>
> (4) The Commission may, by notice in writing, declare any class of rules of a stock exchange to be a class of rules whose amendments do not require the approval of the Commission under subsection (3), and accordingly, any amendment to the rules of a stock exchange that belongs to that class shall, subject to subsections (5) and (6), have effect notwithstanding that they have not been so approved under subsection (3).

(5) Where the Commission is of the opinion that any amendment to the rules of a stock exchange made under subsection (4) does not fall within the class of rules declared by the Commission under that subsection as not requiring its approval, the Commission may, after consultation with the stock exchange, require the stock exchange to submit such amendment for its approval under subsection (3).

(6) Where a rule amended by the stock exchange under subsection (4) is the subject of a requirement made by the Commission under subsection (5), such amendment shall cease to have effect from the date of the Commission making such a requirement or such later date as the Commission may determine:

Provided that this subsection shall not have effect until a reasonable time has been given to the stock exchange to notify the persons affected by such amendment.

(7) Notwithstanding the provisions of this section, the Commission may, from time to time, after consultation with the stock exchange, by written notice require the stock exchange to amend the rules of the stock exchange in such manner and within such period as may be specified in the notice.

(8) A stock exchange which fails to comply with subsection (2) or which fails to comply with a requirement made under subsection (5) or a written notice made under subsection (7) commits an offence.

(9) A notice under this section may be served personally or by post.

There could be little doubt that the securities commission maintains a tight reign on the rule making power of the committee of the KLSE. A failure on the part of the KLSE to comply with the directive of the commission with respect to the amendment of rules of the exchange exposes the KLSE to prosecution under s. 9(8) of the Act. This notwithstanding, there is no statutory control or for that matter any prohibition or stricture over the force-sale of shares by member companies of the KLSE. All that s. 9 injunct upon to ensure due compliance of its directives is on the KLSE as a body corporate and not its component members such as the plaintiff. One can therefore conclude with some degree of certainty that the act of the plaintiff in selling the shares on dates later than the 8th day of transaction, had not contravened the Securities Industry Act 1983 or indeed any law written or otherwise although it may have been in breach of sub-reg. 3 (*supra*).

In fact the Federal Court had ruled (in a case which involved the formation of a contract rather than its performance as in the instant case) in *Theresa Chong v. Kin Khoon & Co* [1976] 2 MLJ 253, that share transactions executed through an unregistered remisier, was perfectly valid although it involved a more serious breach of the rules and regulations of the KLSE then subsisting. The court struck down the argument that such a contract was illegal and that

it should not lend its hand to a plaintiff to enforce a contract which had contravened the rules of the exchange. It held (per Gill CJ, Ali and Ong Hock Sim FJJ concurring) that:

> Not being registered as a remisier is not contrary to public policy because the bye-laws of the Stock Exchange are the bye-laws of a private body which have no force of law. They are binding on the plaintiffs but not on the defendants. If the plaintiffs were dealing with an unregistered remisier they were committing a breach of bye-law 97 of the Stock Exchange Rules which provides for a penalty. But their dealing with such a remisier did not make such a contract illegal as being opposed to public policy.

The case was applied more recently by the Court of Appeal in *YK Fung Securities Sdn Bhd v. James Capel (Far East) Ltd* [1997] 4 CLJ 300 in a yet more serious breach which offended against s. 84 of the Securities Industry Act 1983 relating to false trading and market rigging, where the court appeared to have held that even in such an instance no such contract may be invalidated on grounds of public policy.

The ruling in *Theresa Chong (supra)* had also been followed across the causeway in *RHB-Cathay Securities Pte Ltd v. Ibrahim Khan and Other Actions* [1999] 3 SLR 464 at 478, wherein it was held by the High Court Singapore that share dealings transactions conducted in breach of the plaintiff's obligation under the Singapore Stock Exchange (SES) Rules and Bye-Laws to exercise proper supervision over its dealer would not render them void or illegal on ground of public policy. The breach had merely exposed the plaintiff to being penalised by the SES.

The Terms And Conditions Agreed To Between The Parties

Having found that the performance of the agreement by the plaintiff in selling the shares after the 8th day of transaction has not been rendered unenforceable under any statute, it follows that the issue has to be resolved by the terms and conditions written or implied which have been agreed to by the parties.

That the defendant had signed the "account application - for individual " form (agreed bundle of documents - 1, pp. 204 and 205) is now conceded. The completed form signed by both the parties therefore constituted the agreement by which they had agreed to be bound. In order that the contractual commitment made by the defendant may be understood, it is necessary that I set out in extenso the clauses as they appear in the form:

> By signing below, I ...
>
> (a) request you to open an Account in UMBC Securities Sdn Bhd (UMBCS) and undertake to abide by the Rules and Regulations of the Kuala Lumpur Stock Exchange and the Securities Industry act.

(b) undertake to make immediate payment against delivery of stock and/or shares purchased on my behalf. I undertake to pay the amount of deposits required by you on purchase contract made on my behalf. The balance of which (if any) will be paid immediately on delivery of stocks and/or shares or as requested by you.

(c) undertake to deliver promptly any stocks and/or shares you may have sold on my behalf and hereby authorise you to deduct from my account with you and/or the proceeds from the sale of the aforesaid such sum or sums equivalent to the entitlement or rights pertaining to the aforesaid in his/ their name(s) in time for the entitlement and/or rights pertaining to the aforesaid stock and/or shares.

(d) hereby authorise you to sell out or buy in such stocks and/or shares as may be required to clear my position with you and I undertake to indemnify you against all losses in such events should I fail to comply with paragraphs (a), (b) and (c) above. You may offset any amount outstanding due to you from my sales proceed or contra gain or withhold the release of shares (in custody or registration) pending clearance of my dues.

(e) agree to pay you late payment charges at the rate to be determined by you from time to time plus handling and service charges on the settlement on my part.

(f) authorise you to deal with all the stocks and/or shares bought for my account for which I have not paid in any manner you deem fit.

(g) declare that the proof of posting by ordinary mail by you to me of the contract note, contra statement and/or other documents to me shall be deemed to have been duly received by me in the ordinary course of post.

(h) hereby irrevocably authorise you to release any stocks and/or shares purchased by me to Remisier or any of authorised representatives.

(i) Malaysian law shall govern the relationship between the applicant and UMBCS as client and stockbroker, respectively and, as between the applicant and UMBCS, all transactions effected by UMBCS in pursuance thereto. The applicant agrees to submit to the non-exclusive jurisdiction of the courts in Malaysia in the event the applicant is not a resident in Malaysia.

(j) declare that all orders made through the telephone shall be deemed to be confirmed.

(k) the acceptance and continuance of this account shall be entirely at the discretion of the company.

(l) authorise the company to verify and exchange information contained in this application form and any such information relating to the applicant's particulars, bank account(s) between UMBCS and such other third parties

as may deem appropriate for the purpose of approving this application and for such other purpose as long as the applicant shall remain a client of the company.

(m) declare that the information given herein are true and correct.

The undertaking of the defendant to abide by the Rules and Regulations of the KLSE and the Securities Industry Act 1983 in (a) above necessarily carries a reciprocal obligation on the part of the plaintiff to observe the same rules and regulations that all shares not paid for by the 7th day of transaction would have to be forced-sold by the 8th day of transaction. But this does not necessarily mean that the parties were not free by consensus to modify the requirements of the rules for their mutual benefit such as to postpone sales to a date when the shares would fetch a higher price. In law the performance of a contract can be varied by the mutual consent of the parties (*Berry v. Berry* [1929] KB 316). Thus in *Paul Murugesu Ponnusamy (as representative of Nalamah Sangapillay (deceased)) v. Cheok Toh Gong & Ors* [1996] 2 CLJ 397, the Supreme Court in finding that the parties to a contract for the sale of land could vary the term of a contract requiring a written notice to be served to complete the sale by the giving of an oral notice, held (per Peh Swee Chin SCJ) at p. 408.

In the first place, both parties to an agreement are entitled to vary any term of the agreement in writing, or orally, where oral evidence of such variation can of course be given, to quote s. 92(d) of the Evidence Act 1950, 'save in cases in which the contract, grant or disposition of property is by law required to be in writing, or has been registered according to the law in force for the time being as to registration of documents'. The above agreement is not of those excepted cases.

It is important to remember that when it is sought to prove a variation, not by an express agreement but by a course of conduct, that both parties have understood the variation and intended to be bound by it. In the instant case, the variation in question was sought to be proved by a course of conduct, *vide* the evidence set out earlier, and the court would have to be satisfied that the variation to cl. 3 in question was both understood by the purchaser and the vendors, and that they all intended to be bound by it. What the court would have to be so satisfied would depend on the surrounding circumstances.

The plaintiff in the instant case would only be contractually obligated to sell the shares on the 8th day in strict compliance of the rules of the KLSE, if and only if the parties had intended all along in the course of their dealings that all the shares that had not been paid for by the 7th day must be forced-sold on the 8th day without exception in which case the plaintiff would be committing a breach by selling them after the 8th day.

The uncontroverted testimony of the plaintiff's witness Leow Yuen Fong alone, that the shares were sold only after the 8th day of transaction only because the defendant had requested for time to pay for them, provides the necessary evidence that the parties had varied the force-sale regulation to the extent that it was perfectly legitimate for the shares to be sold at a date later than after the 8th day. But, even discounting Leow's evidence, the conduct of the defendant attracts the doctrine of estoppel as restated by the Court of Appeal in *Teh Poh Wah v. Seremban Securities Sdn Bhd* [1996] 4 CLJ 16 - on account of the fact that the defendant had not raised any objection whatsoever over the sales of shares by the plaintiff when he was expected to do so if he had not agreed to the sales and in the process influenced the plaintiff to believe that the sales was perfectly regular.

Additionally, the plaintiff was entitled to rely on cl. (f) which authorised it to deal with the shares "in any manner you deemed fit" to sell them at the appropriate time they deemed fit. Provided the sale was conducted *bona fide* to recover the loss that the plaintiff may have to incur by the failure of the defendant to pay for them, the sales could not be impeached.

The plaintiff is entitled to enter judgment as prayed. The counterclaim of the defendant for losses suffered by reason of the force-sale must accordingly be dismissed with costs.